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## Frontier of Islamic Economics and Finance: New Challenges

### Integrating Moral in a Dynamic Model of Corporate Social Responsibility in Islamic Economics and Finance

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#### Abstract

This paper focuses on Corporate Social Responsibility (CSR) in Islamic Economics and finance. The escalating social and economic problems in particular during the current financial crisis have raised new questions as well as expectations about corporate governance, ethical and social responsibilities. Commentators have raised “ethical” as the missing link in financing and also in running financial institutions. Corporate Social Responsibility (CSR) has emerged and developed with the aim of constructing and directing the social responsibilities of economic and financial institutions. The main objective of this paper is to study the concept of CSR from an Islamic perspective with special reference to the moral values that are essential in Islam. Importantly, Islamic banks are criticized for not considering the social dimensions related to development, which is an essential distinguishing point of Islamic moral economy. This paper therefore attempts to respond by suggesting a new paradigm within CSR framework to help Islamic banking and financial institutions to overcome the gap between aspirations and realities. As a concrete policy implication, the paper suggests that Islamic banks should shift from the practice of giving charity and *zakah* in a traditional manner to a more systematic method of performing charity and *zakah* in order to ensure community development.

#### Introduction

The shock awakening of the global economic crisis proved guilty beyond doubt the current financial practices which have generated social problems such as poverty, decline in moral values, environmental destruction, crime, and unemployment in addition to reckless financial attitudes. Hence, the search for morality and ethics became a quest to reconcile the deep wound in the world’s purely interest based financial system. Interestingly, Corporate Social Responsibility (CSR) related concerns were raised during the crisis and this effort did not lessen except in the case of total bankruptcy [Møller 2009]. CSR became an important subject which was neither

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abandoned nor diminished but instead welcomed openly. As reported by KPMG [2008], only 50 percent of companies surveyed in year 2005 reported their CSR activities, which increased to 80 percent in 2008 indicating a positive shift towards ethicality. The drivers that force this upward shift in CSR reporting were mainly ethical considerations and a greater emphasis on efficient risk management. Indeed, the cause of the crisis was related to unethical behaviour caused by greed and a materialism which lead to irresponsible actions and a total disregard for ethical values in business transactions.

By its very nature and construct Islam stipulates a moral economy, and therefore as its economic system, Islamic banking and finance (IBF), is expected to fulfil such aspirations. This implies that Islamic moral economy aims at CSR from a religious angle, as the promotion of socio-economic justice, and social and environmental concerns are values inherited from Islamic moral economy.

IBF, which has been operating for about forty years, came as a revelation to the banking system in combating this turmoil. Besides this, the world has been watching the Islamic banking industry since its acknowledgment by the International financial system, to see whether it is resilient to the crisis or not. This could be evidenced from the eagerness of certain non-Muslim countries in Europe and Asia such as the UK, France, Singapore, Japan, South Korea, China and Hong Kong to encourage the practice of Islamic finance, believing it to be a future market leader. Besides this, IBF, based on the Islamic economic system is to be said less affected by the crisis since it endorses socio-economic justice.

The aim of this study is to locate the ethical values which are incorporated in CSR from an Islamic perspective. Specifically, CSR will be studied from the concept of Islamic economics and finance. Hence, this paper offers an understanding of CSR from an Islamic worldview by discussing Islamic values that are consistent to the CSR concept. This paper will be presented in five sections, Section I being the Introduction. Section II offers an overview of the concept of Corporate Social Responsibility. Section III discusses the role and significance of religion towards ethical values. Developing from these two sections, this paper will elaborate on the concept of CSR from an Islamic view in Section IV. Then, Section V will expound the Islamic Moral Economy. Section VI explains the role of CSR in Islamic economics and finance. The paper is concluded in Section VII.

## **1. Corporate Social Responsibility (CSR): An Overview**

The concept of CSR has been evolving for more than half a century up to the present day, and

finding the most suitable definition is a challenge. CSR has different meanings to different people according to different situations [Cama 2004]. In the 1950's, Howard R. Bowen, who is commonly known as the 'Father of Corporate Social Responsibility,' explicitly claimed the importance and responsibility of corporations to fulfil the social welfare demands made by the society [Carroll 1999]. This covers every business decision and operation that could influence the society's life. CSR then was referred to as a guideline for businesses to be socially responsible [Masaka 2008].

However, as the literature has proliferated, so the definition of CSR has been dissected into more specific details. CSR is associated with certain traits such as gender equality, fair treatment, human rights, women's rights, employee's rights, environmental awareness, charity and philanthropy. The importance of CSR has made it a 'licence-to-operate' a business by ensuring that every business operation must be efficient and effective, for without it the future of the business is at stake [Zinkin 2004].

Although the prospects of CSR benefiting the society may have sounded very promising, there were always issues opposing this spirit. CSR has been criticised since its early infancy. Among the most prominent arguments was the one that claimed the responsibility of business was only to maximise profit, and CSR should be left to the free market. However if this fails, then the government and legislation should come forward to perform it [Carroll and Buchholtz 2006; Friedman 1970]. Another strong factor contesting the concept of CSR was that it was costly and thus only rich and financially stable corporations could operate a CSR program [Handy 2002]. Many other criticisms of CSR have continued until today, such as that it is time consuming, uses up human resources, bureaucracy and so on.

Despite all the arguments and criticism, CSR has been growing and moving towards a stable platform. CSR is not only performed by non-profit organisations, rather the banking sector is slowly moving towards being more socially responsible. This is supported by the existence of ethical and socially responsible banks in Europe and other parts of the globe such as Triodos Ethical Banking, Ethical and Green banking, The Co-operative Bank, Grameen Bank, Nasser Social Bank and many more. Commercial banks are also keen to embed CSR measures in their policy to be seen as more responsible to the community. For example, Standard Chartered bank, HSBC and Deutsche Bank are very committed to CSR activities such as helping the poor, contributing to environmental awareness, adopting social investment and also nurturing arts.

## 2. Religion and Ethical Values

Ethical behaviour is suggested to be a prescriptive value that is normally embedded in one's character. Ethics stands on the principles of good behaviour and doing what is right and acceptable to society. Mousa [2007] asserts that ethics are behaviour beyond the legal requirements which act as the basic code of ethics. Ethical values such as truthfulness, honesty, justice, and fairness are not inherited but need to be nurtured. Ethics are normally mentioned interchangeably with morals and actually have a similar definition. Indeed, morals are also concerned with the principles of 'right' and 'wrong'; 'good' and 'bad' behaviour which can eventually be differentiated and judged. As affirmed by Boatright [2007], morals and ethics are similar and always used together. The difference is that the word 'ethic' originates from Greek and 'moral' comes from Latin.

In locating the root of ethical values, religion has always been associated with enjoining good behaviour. In fact one's religion, which is a set of beliefs in God(s) has a significant influence on one's perception of CSR [Brammer *et al.* 2007] that could change one's social attitude and personal values [Wilson 1997]. Hence, at this point it is relevant to explore the impact of religion on ethics from a business perspective.

This study will only focus on the *Abrahamic* faiths that are among the oldest religions in the world. These three religions; Judaism, Christianity and Islam have much in common. They are commonly known as monotheistic religions that uphold belief in one God. Interestingly, these religions share common ground in acknowledging God-centred values and the commanding ethical behaviour in every walk of life as prescribed in their Holy Books. By acknowledging God as the Almighty Creator, one is obliged to submit to His Will and Command and to show Him gratitude [Choudhury 1989]. Besides, men are regarded as His caretakers who ensure that His wealth is managed in a responsible and ethical way [Green 1997; Pava 1998; Yousri 2005]. Each religion has specifically mentioned following ethical norms and regulation with regard to economic activities as a way to achieve divine blessings.

In referring to economic activities, these religions agree upon two practices; 1) they prohibit *riba* or usury and 2) they encourage lending to the poor.

Jews believe that usury is forbidden [Green 1997]. However, lending with interest to a non-Jew is permissible. This is simply because Jews have a very strong bonding with each other and performing this unjust act would jeopardise their relationship. Each of them is treated with trust and they uphold the concept of brotherhood as a very important value [Buckley 2000; Wilson

1997]. Another reason for prohibiting usury is to avoid any exploitation of the poor and needy. In Christianity, usury was prohibited for more than 1400 years [Abbasi *et al.* 1989]. The famous Roman Catholic scholar, St. Thomas Aquinas was against the act of usury which brought the lender money without any effort. He regarded it as a sinful act, and this was actually a dogma of the Catholic Church at that time. He claimed that money was a fungible good and that its value might fluctuate from time-to-time. It was a medium of exchange and not for creating money out of money [Buckley 2000; Wilson 1997]. Islam also condemns the act of giving and taking *riba* as it has a negative impact both economically and socially. *Riba* does not promote economic growth and also creates unbalance in the society. This unethical act is unjust and will only create chaos by making the poor poorer and the rich richer; in the end it creates a wide gap in the society that will eventually lead to social corruption.

Further common practices among these religions are the giving of charity and lending to the poor. In Judaism, it is a priority to lend money to family members who are in need of help before extending it to the society at large [Pava 1998], while in Christianity it is a religious call to share one's wealth by helping the poor and needy through money lending. Charity must be done voluntarily without duress from any entity such as the church or state property [Wilson 1997]. In Islam the *Qur'an* mentions helping the poor and needy repeatedly and indicates several ways to them, such as by giving *sadaqah* (charity), *zakah* (alms) and *waqf* (endowment). The implication of these practices is to promote the welfare of society by sharing one's wealth and by feeling empathy with the poor. Avoiding greed and ill behaviour among property owners would make the society a better place [Sairally 2007]. In addition, Islam regards highly the giving of *qard hasan* (a benevolent loan) to the needy instead of giving them charity. This is to ensure that the recipient makes an effort to repay the creditor, for such behaviour is highly valued by God. Prophet Muhammad (pbuh) narrated that the reward granted from Allah for *qard hasan* is in fact greater than for giving *sadaqah* (*Hadith*: Ibn Majah & Baihaqi).

The role of religion has indeed influenced the establishment of business ethics as practiced today. Among the ethical values are the practices of just price, fairness, honesty, transparency and many more. Hence, business ethics which is rooted in the religious teachings upholds socio-economic justice.

### 3. The Concept of CSR from Islamic Perspective

Although the principles of CSR have been respected in the West for more than half a century, it has only quite recently been explored in the Islamic context. Similar to CSR from a Western

perspective, achieving a common definition of CSR from an Islamic point of view would be perplexing. Moreover, at the moment, there are only a few researchers who focus on this subject. Thus, there is no commonly accepted definition that could be employed at the moment.

Knowledge of Islam begins from the fundamental understanding of the Islamic law which will be explained below. For a Muslim, *Shariah* law, which governs every aspect of life, should never be abandoned.

### **3.1 Fundamental Source: The Shariah Framework**

The central objective of *Shariah* is to promote *Maslahah* (public good) and to fulfil a human's well-being by relieving them from hardship in this World and in the Hereafter. Further, its law is created to improve and perfect the quality of life by establishing 'adl (justice) and educating people. It advocates the holistic view of Islam by highlighting the elements of *akhlaq*, that is the moral and ethical values in all aspects of life [Azid and Asutay 2007; Chapra 1979; Dusuki and Abdullah 2007]. The relationship between *aqidah* (faith) and *akhlaq* (ethics) is that *aqidah* is the foundation of an Islamic system that depicts *Shariah* as the source of guidance in performing the ethical behaviour that is demanded by God.

*Shariah*, also commonly known as Islamic Law, is divided into two major constituents; 'ibadah (ritual worship) and *muamalah* (social transactions). The former relates to the relationship between man and God which also is indicated as a vertical relationship, while the latter is horizontal and signifies the relationship with fellow human beings [Naqvi 1994]. The vertical equality depicts that God gives equal rights to everyone regardless of race, colour, gender and so on.

The bedrock of CSR from an Islamic worldview is the divine source prescribed by God, the Holy *Qur'an*, and the Prophet's *Sunnah*. Additionally, two other sources which acknowledge human reasoning are used to complement the divine sources, *ijtihad* (mutual consensus) and *qiyas* (analogy). These sources of reference are employed according to sequential orders to solve any newly arising matters which are not stated clearly in the *Qur'an* and *Sunnah*. Hence *Shariah* is not only a law but also a source of guidance in every walk of life.

### **3.2 Philosophical Tenets**

The philosophical tenets that will be outlined below are the backbone of the Islamic economic system. Fundamentally they revolve around the notion of *taqwa* (God-consciousness) that is paramount in Islamic belief, whereby a believer must do his utmost to achieve the best possible reward in this World and Hereafter. *Taqwa* is a believer's awareness of God's presence in his or her daily life and transactions with others [Iqbal and Mirakhor 2007].

It is not an exhaustive ideology that covers the whole system since there are other peripheral elements which complement it; however these tenets are the main subject without which Islamic economics would not exist.

(i) *Tawhidic* Approach (Oneness of God)

Man is created by God as His steward to cultivate and enjoy His bounty on the Earth. Besides, it is prescribed in the *Qur'an* [51: 56] that men are created to serve and worship the Almighty. It is very important that this core tenet be embraced by every Muslim in achieving the spirit of *taqwa* (God-consciousness). Thus, by acknowledging God as the Creator and Owner of the Universe, man relinquishes any right to the property they possess. Yet, men are appointed as an agent or a trustee to ensure this property is used in wholesome and responsible way that does no harm to themselves or to others [Abbasi *et al.* 1989; Ahmad 1980; Nomani and Rahnema 1994; Siddiqi 1980; Utvik 2006; Zarqa 1980].

*Tawhid* has three branches. *Rububiyyah*, being one of them, implies that it is a very important axiom for the development of Islamic economy. *Rububiyyah* as described by Ahmad [1980] is a divine avenue for nourishment, sustenance and directing things towards perfection. This entails that God Almighty encourages work to be done with the best effort for the best outcome. *Rububiyyah* is the source of axioms in directing towards a robust Islamic economy at a sustainable level besides being a tool for competitive advantage.

(ii) *Ukhuwwah* (brotherhood) and Unity

*Tawhid* not only confirms the relationship between men and God but also determines the relationship between men and the rest of God's creation, especially with other human beings, by asserting the role of *ukhuwwah* and unity [Naqvi 1994]. Islam respects both the right of individualism and also collectivism. Each individual is treated as a family member embracing the spirit of brotherhood and rejecting discrimination on account of wealth, status, race, colour, and origin, etc. While the idea of collectivism leads to a spirit of equality and unity with each other [Iqbal and Mirakhor 2007], within Islamic sphere, brotherhood denotes broader responsibilities that suggest collective cooperation and safeguarding each other's well-being. The implication of instilling the spirit of brotherhood is that it would shape a better society with a high regard for social welfare, since such people will be passionate to ensure a better life, not only for themselves but for everyone.



(iii) *‘Adl* (justice)

Man has been created by God and appointed as His *khalifah* (vicegerent) on the Earth to cultivate and develop its bounty. Thus, as a vicegerent, man is required to establish justice and forbids any destructive activity in the pursuit of a balanced and harmonious system. Islam is a religion that adheres to the principle of justice as paramount as prescribed in the *Qur’an* [57: 10]. Justice is not established for human beings only, but for the universe as well [Abbasi *et al.* 1989]. The upholding of justice generally depicts the level of piousness and God-fearing of a Muslim [Chapra 1979]. Justice is extended to a broader horizon beyond law and regulation. It includes morality; such values are rationality, fairness, equality and ethics. Hence it is known as the social equilibrium which Naqvi [1994] asserts is *‘adl wal ihsan* (justice and kindness) which brings social justice to the society. In Islamic economics, social justice is a crucial principle to ensure a fair economic system. Social justice as viewed from [Nomani and Rahnema 1994] inculcates two important elements; equity and equality. These two elements have strong positions articulating the role of justice. Equity is referred to as a just reward according to the effort made and not given equally to everyone. Hence, whoever makes the best effort will get the highest return. Equality is understood as the equal rights that all human beings share from God’s view without any discrimination. God entrusted His vicegerent to share His bounties on the Earth with every human being. Indeed from the Islamic economic point of view, the poor have a right to the wealth of the rich. Therefore, socio-economic justice should be established in fulfilling human rights by providing equal opportunity such as equitable income and wealth distribution. In addition, *zakah* and *sadaqah* would also be good tools for alleviating poverty and overcoming social problems.

(iv) *Tazkiyyah* (growth and development)

To ensure that Islamic economics is sustained in the financial industry, it is vital to implement this last axiom. Making efforts towards improvement and perfection in order to succeed in this world and the Hereafter is very significant in Islam. It is an exclusive process of self-purification to improve the quality of life [Nomani and Rahnema 1994] containing elements of morality, spirituality and worldliness. These integrated elements are the sustenance for the robustness of the Islamic economic system.

These philosophical tenets explained above represent the spiritual element that should be embraced to shape a moral economic system that also acknowledges the concept of *taqwa* as a central belief. Hence, the Islamic economic system truly follows a different path from the conventional economic system based on capitalism which excludes moral values.

#### 4. Islamic Moral Economy: The Way Forward

Since the recent economic crisis, many economists have tried to find solutions to aid the recovery of the whole economic system. Among their ideas was the integration of moral values with capitalism. As far as we are concerned, capitalism is purely maximising profits, which makes it a challenge to incorporate moral values in business transactions.

At this point, moral economy, which is more traditional, comes to mind. Moral economy is normally associated with the values of justice, fairness and equity and is commonly known to be effective in a small community.

Reviewing and understanding the whole concept of Islamic economics, it is suggested that Islamic economy falls under the category of moral economy in that it deems the assimilation of moral values and/or cultural beliefs with economic activities. The cultural beliefs that are mentioned here could be referred to as the holistic values of Islam. Moral and ethical values according to the Islamic view are known as *akhlaq*. Thus, the components of Islamic moral economy are: *aqidah* or faith together with *akhlaq* or moral and ethical values that shape the nature and substance of economic and financial activity.

The objective of moral economy is rather similar to Islamic economy in that it promotes social justice. Hence Tripp [2006] introduced it as Islamic Moral Economy. Islamic economy was ideally discussed in earlier literature by Ahmad [1980], Chapra [1980], Siddiqi [1980] as an economic system that follows the *Shariah* parameters which ought to accomplish the objective of social and economic justice. Yet in reality, if we consider the last thirty years, it is still far beyond reach and it hasn't contributed much to development in the Muslim countries [Zaman and Asutay 2009]. Hence, renaming it as 'Islamic Moral Economy' would at least alert the current practice of IBF to reconsider its original purpose. Clearly, this system is in competition with capitalism, which has failed to uphold moral values. However, it is reckoned that it is more effective in delivering material benefits for the development of the economy [Siddiqi 1980; Tripp 2006] as it is more transparent and ethical.

The essence of Islamic moral economy very much relies on the concept of CSR which at this instance has made a great contribution towards being God-consciousness or *Taqwa*-centric in Dusuki's [2008: 21] CSR continuum. Achieving the state of an Islamic moral economy would be utopian if one could only forgo being materialistic. At this level, everyone should be socially responsible by their own will and because of their God-consciousness and not for the sake of any financial gains or losses. The lowest level in the pyramid describes how irresponsible a person

could be, even to the point of breaching the moral standards of human civilization. Such deviant behaviours are fraud, misrepresentation, violating human rights, polluting the environment and so on, which are in fact strictly against the *Shariah*. However, the other traits are all *Shariah* compliant. In brief, the minimalist, apathetic and tactical approach does acknowledge the presence of social responsibility and only differs according to the level of its contributions and involvement in this field. A company with a minimalist approach normally satisfies the minimum legislation requirements, and performing CSR would not be an important subject on their agenda. A business with an apathetic approach is committed to the law and also to certain moral responsibilities, but there is no serious or strategic effort to perform CSR. Companies with a tactical approach operate beyond the legal requirements by exercising a voluntary contribution to society and the environment and CSR is definitely among the objectives or policies of such an organisation.

## 5. The Role of CSR in Islamic Economics and Finance

It seems that every time a financial problem has occurred, morality and ethics have come to mind to save the day. In the recent financial crisis, there was an endless argument about who was to blame. Albeit, it has been discovered that among the problems pointed out was an irresponsible way of banking and investing which revealed the failure of risk management and poor governance at the banks. On the contrary, Islam emphasizes that transparency should exist at every level. Thus, Islamic economic's scholars call for Islamic banks to be socially responsible to ensure socio-economic development [Sairally 2007]. Khan [2004] interprets the intersection of economic and social aspects as the 'zone of sustainability' which is suggested as an ideal and balanced framework for a moral banking system. Indeed, the aspiration to create an ideal banking system would be a challenge especially in attempting to satisfy all the different needs of the society.

At the moment, Islamic banks are being very thorough in their governance to ensure a resilient system at the operational and managerial levels. Indirectly, CSR has very much influence on overall business operations. At the operational level, *Shariah* has strictly pronounced the prohibition of *riba* (interest), *maysir* (gambling) and *gharar* (uncertainty). Moreover, Islamic banks must also avoid anything that is impermissible and immoral. With this in mind, the *Shariah* screening of products is essential to ensure that all *haram* products or transactions that could contribute to the detriment of society and the environment are avoided. For instance, businesses dealing with liquor, pork, arms, adult entertainment, pollution and so on are

prohibited. On a managerial level, Islamic banks are committed to being socially responsible by collecting, managing and distributing *zakah*, performing charitable and philanthropic activities that contribute to community development, upholding employees' rights and being environmentally friendly.

Ramadan is deemed as a Holy month in Islam whereby each and every Muslim will be enthusiastic to perform good deeds. Thus, it also inspires the extensive performance of CSR in Islamic banks. The New Horizon magazine reported that many Islamic banks around the World such as Maybank Islamic Bank, Saudi Arabian Bank, Shamil Bank of Bahrain and Qatar International bank have taken this important opportunity to enhance the practice of CSR with a twofold intention of achieving success in this World and Hereafter.<sup>1)</sup>

As there have been many disputes on the social failure of Islamic banks, Asutay [2008] regards that most Islamic banks have simply regarded the role of performing *zakah* distribution and non-systematic charitable activities as performing CSR. It has been reported in a study conducted by Sairally [2005] at 50 Islamic banks and IFIs that they have CSR deficiencies in terms of not having a systematic method for giving back to the society. She found that they do distribute *zakah* and undertake charitable giving; but this does not contribute to developing the socio-economic capacities of the societies in which they operate.

As reported from a survey conducted in 2009 by Dinar Standard and Darul Istithmar at 29 IFIs around the globe, 77 percent of IFIs see charity as a priority deed and support this activity. While discussion on giving more concern to the performance of charitable services continues, ways to cure social ills have not been resolved and programs for community development are yet to be included in the picture. The banking sector and governments should play an active role to ensure CSR is practiced extensively beyond *zakah* and charity, and in this instance, learning from their conventional counterparts is a must.

With the growing concern for CSR, it is timely that Dinar Standard and Darul Istithmar [2009] issued a CSR report on Social Responsibility Trends in Islamic Financial Institutions (IFI). This study is among the first to examine CSR in IFIs around the world which is a very good effort for the contribution of CSR from an Islamic perspective, yet it fails to cover the real impact of social responsibility towards IFIs. The survey has employed indicators from the AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) Standard which covers 13 aspects of social responsibility such as client engagement, employee welfare, charity,

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1) "Ramadan Inspires CSR in Islamic banks." *New Horizon*. Retrieved from <<http://www.newhorizon-islamicbanking.com/index.cfm?section=news&action=view&id=10819&return=search>>.

environment, investment quotas and others. These 13 aspects are not exhaustive since CSR is a very broad subject. However, it could be used as a guideline that could be updated from time to time. Islamic banks should adopt this guideline in their practice in order to fulfill the aspiration of CSR.

## Conclusion

This paper discusses the concept of CSR from an Islamic view with special reference to the moral values that are essential in Islam.

The concept of western CSR that highlights ethical and moral values is inevitably embedded in *Shariah*. Hence it is relevant to and supports the objective of Islamic economics and finance. It is an essential tool that would bring IBF to the next level, as well as making it resilient and unique. However, in making this a reality, it is suggested that IBF be morally conscious by re-examining the objective of Islamic (moral) economy that upholds the spirit of socio-economic justice. This could be evidenced from the example of the empirical study provided that shows the practice of CSR in Islamic banking is still incomparable to its conventional counterparts. Islamic banks should come out of the dogma of giving charity and performing *zakah* in a traditional manner in order to be socially responsible. Furthermore, they should extend it to a wider sphere that contributes to socio-economic growth. At this point, a systematic method of giving charity and *zakah* is needed to ensure that community development and the welfare of society at large is guaranteed.

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